CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

July 30, 2004

H.R. 4879
Military Housing Improvement Act of 2004

As passed by the House of Representatives on July 21, 2004

SUMMARY

H.R. 4879 would increase by $500 million the statutory limit on the amount that the Department of Defense (DoD) can invest in projects to acquire or renovate military family housing using the alternative authorities provided in title 10, United States Code. Those authorities permit DoD to use direct loans, loan guarantees, long-term leases, rental guarantees, barter, direct government investment, and other financial arrangements to renovate, build, and operate military housing in concert with residential housing developers.

Currently the amounts in the fund are available for use by DoD to acquire housing using the various techniques mentioned above, but the total value of commitments for all contracts and investments undertaken is limited to $1 billion ($850 million for family housing and $150 million for unaccompanied housing). To date, DoD has used $580 million of this investment authority and expects to exhaust the remaining $270 million in authority by the end of calendar year 2004. Under the act, the limit for family housing would increase to $1.35 billion, permitting DoD to pursue additional family housing projects using those alternative authorities. CBO estimates that enacting H.R. 4879 would increase direct spending by $149 million in 2005, $2.1 billion over the 2005-2009 period, and $2.2 billion over the 2005-2014 period.

H.R. 4879 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact is shown in the following table. The costs of this legislation fall within budget function 050 (national defense).

	By Fiscal Year, in Millions of Dollars									
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
CHANGES IN DIRECT SPENDING										
Estimated Budget Authority	1,286	951	0	0	0	0	0	0	0	0
Estimated Outlays	149	627	750	402	165	79	33	9	0	0

BASIS OF ESTIMATE

CBO estimates that enacting H.R. 4879 would cost $2.2 billion over the 2005-2014 period. That amount, which CBO believes should be counted as new direct spending, reflects the estimated governmental costs corresponding to the $500 million increase in the DoD "investment cap" on the department's investment in projects to acquire or renovate military family housing. The rationale for treating the full costs of such projects as an up-front government expenditure is explained below, along with the basis of our estimate for the proposed cap increase. In short, CBO believes that the public-private ventures entered into by DoD and its private-sector partners should be treated as governmental for budget purposes because the federal government exercises substantial control over the housing projects and because the government is the dominate or only source of income for those projects.

Funding Governmental Activities

DoD has traditionally acquired housing for military personnel by contracting with housing developers or construction firms to build housing units on or near military installations—paying the builders as they performed and completed construction. The U.S. Treasury makes those payments using cash from tax revenues, receipts from the sale of Treasury securities, and fees paid to the federal government.

Using the alternative authorities for acquiring or improving military housing provided in title 10, United States Code, sections 2871-2885, the department also acquires housing in a more complicated—and ultimately more expensive—manner. Although each family housing project DoD accomplishes under its Military Housing Privatization Initiative (MHPI) has unique aspects, they have many contractual elements in common. DoD enters into an array of long-term agreements with a residential housing developer who establishes a limited liability company (LLC), partnership, or other special-purpose entity (SPE), specifically for the purpose of renovating, constructing, operating, and maintaining the military family housing at the project. These agreements establish government control over the project, protect the government's interests, and ensure that DoD will receive guaranteed access to the housing.

Legal and Financial Structure of MHPI Projects. Once DoD selects a contractor to build or renovate the housing at the project, the contractor and the government generally establish an SPE. In the majority of the projects awarded to date, the government is a member of the SPE. The department then makes a variety of contributions to the SPE. For instance, it usually provides land to the SPE, most often through a 50-year ground lease, although in a few projects, the developer provided the land on which the housing was built. DoD also conveys title to the existing housing units on the land. At that time the military families who occupy the housing must immediately begin paying rent to the developer. DoD provides those families a Basic Allowance for Housing (BAH) using funds from military personnel appropriations so that they can make the rental payments to the developer. (Prior to the conveyance, the families do not receive BAH, but live in the housing free of charge.) DoD may also provide direct loans, loan guarantees, or cash to the SPE.

On behalf of the government, the SPE then borrows additional money to finance construction for the project from a third party such as a commercial mortgage corporation. In other words, the SPE acts as an intermediary by borrowing money—in place of the U.S. Treasury—to finance a governmental activity. The value of the assets contributed by the government serve as collateral for the borrowing, and the future rent payments from military personnel who will occupy the housing provide a reliable source of income for debt service. But because the SPE faces higher interest rates than the U.S. Treasury, this form of financing is more expensive than direct federal funding.

Budget Principles. With MHPI, DoD has been able to improve or replace housing faster than it would have been able to do using the traditional appropriations process; however, this success is primarily due to the favorable budgetary treatment afforded to DoD's use of these alternative authorities by the Office of Management and Budget (OMB). Rather than viewing the project as a whole, OMB focuses only on certain elements of the transaction, treating DoD's equity contributions to the project as cash, while recording the subsidy costs of direct loans and loan guarantees (as defined by the Federal Credit Reform Act of 1990). OMB does not consider the value of in-kind contributions to the housing venture, nor does it assess the impact of the various long-term agreements between DoD and the contractor, in determining how it records these projects in the budget.

By scoring each transaction in that piecemeal fashion, to date, DoD has been able to acquire more than $6 billion in housing while recording the use of only $580 million in budget authority in the Family Housing Improvement Fund. By recording only a portion of the project's cost in the budget, DoD is able to acquire more housing with a given amount of budget authority than it would be able to if it recorded the full investment amount in the budget. In effect, the Administration's accounting enables DoD to record the costs of the projects incrementally over time rather than up front. As we have stated in past years, CBO continues to believe that OMB's accounting practices for MHPI projects are at odds with governmentwide standards.

A primary purpose of the federal budget is to measure the amount of resources the government draws from the economy, and to allocate those resources among governmental activities. To accurately facilitate these goals, the budget should be inclusive, measuring all governmental activities, not just government liabilities.

CBO believes most MHPI projects are governmental activities—in this case the acquisition, construction, or renovation and operation of a government asset, specifically, family housing for military personnel—financed by a private-sector intermediary who acts as an instrument of the government. In CBO's view, most ventures that borrow funds to construct or refurbish military family housing should be treated as governmental and their investments should be recorded up front, as borrowing authority—a form of budget authority. Amounts expended by these intermediaries, SPEs, or public-private ventures should be recorded in the budget as outlays at the time they occur.

CBO believes these arrangements should be treated as governmental for two principal reasons: the government exercises substantial control over the project and the government is the dominant or only source of project income.

Establishing Government Control. The government exercises significant control over the projects by controlling business operations, occupancy, access, construction, and management through various means. The Department of Defense uses some of the following means of control for each MHPI project; (not all of these techniques are used in any given project).

For example, DoD directs or influences the business operations of the housing project by:

- Acquiring a partnership stake in the housing public-private venture, or membership in the project's LLC, and acting as the only member with the power to remove or replace the other partner,

- Using ground leases and reversionary rights to the land and housing to retain control over property DoD conveys to the developer,
- Restricting the private-sector partner's control of the property by prohibiting the use of property as collateral for other debt without government approval, and by requiring DoD approval of any sale of the private-sector partner's interest in the project,

- Requiring any successor owner to be bound by the terms of the contract between the government and the original developer,

- Controlling the project cash flows and the distribution of revenues through a lockbox agreement—a type of escrow account—which is managed under rules set by the government,

- Making the government the beneficiary of most of the residual income from the project,

- Specifying the amount of rent that can be charged to military and civilian tenants, or

- Approving the terms of the tenant rental agreement.

In addition, DoD controls occupancy and access to the housing by:

- Restricting access to housing that is on a military installation,

- Specifying who is eligible to rent project housing,

- Setting priorities for occupancy among classes of tenants, and

- Restricting the terms under which developers can rent to tenants who are not military families.

DoD also influences construction and management of the housing development by:

- Roughly prescribing the number of housing units in the project and the configuration of those units such as the number of bedrooms and bathrooms in each unit, based on the number and rank of personnel at the installation,

- Retaining the right to approve the developer's construction plans,

- Reviewing and approving the property manager's annual operating budgets,

- Specifying property maintenance and management requirements in the project use agreements, or

- Requiring the developer to perform future renovations and improvements at contractually specified dates.

Providing Project Income. If a project operates as envisioned by DoD, the housing will be almost fully occupied by military families for the full term of the project. (The developer's ability to obtain financing for the project is primarily based on whether lenders believe DoD will have a long-term need for the housing at the project, rather than on the developer's ability to rent the property to other tenants in the event that DoD no longer needs the housing.) Thus, the government, will consume most or all of the useful economic life of the project, and will be the dominant or only source of project income. The government provides that income in several ways by:

- Contributing land and housing units to the developer at no cost,

- Providing cash contributions and direct loans,

- Providing loan guarantees in the event of base realignment or closure,

- Requiring military tenants to pay rent through paycheck allotment, or in some instances providing the developer one lump- sum payment per month for all military tenants in the housing, or

- Reserving the housing units for military families. As a result, most project income comes from funds appropriated for military personnel pay.

In sum, because MHPI projects are governmental activities, CBO believes that the borrowing and spending for the projects should be recorded in the budget as government borrowing and spending.

Cost of Activities Under Current Law

To date, DoD has awarded contracts for 32 family housing projects for a total of 62,000 housing units, and is proceeding with solicitations for or considering plans for more than 60 other projects over the next few years. Using OMB's accounting method, DoD has only recorded obligations of about $580 million—below the current $850 million limit. However, CBO estimates that the full amount of DoD's commitments to date is more than $6 billion. Given DoD's plans for future projects, the department estimates that it could reach the $850 million limit as early as the end of calendar year 2004. Using the current method of accounting for only the initial investment costs of these projects, DoD could acquire or modify approximately 30,000 to 45,000 more units and record only $270 million in obligations. CBO estimates that the true cost of these additional projects, which could be awarded under the current investment cap, would total approximately $3 billion to $4 billion.

Since DoD can pursue these projects without additional legislative authority, their costs are not counted against this act.

Cost of Increasing the Cap

H.R. 4879 would increase the cap on total investment in family housing projects by $500 million, allowing DoD to pursue additional MHPI projects after it exhausts the authority in current law. Currently, DoD has plans to privatize about 170,000 housing units out of a total inventory of approximately 225,000 housing units. CBO estimates that increasing the investment cap by $500 million would permit DoD to renovate or rebuild approximately 25,000 more housing units than it could obtain under current law.

Given OMB's accounting practice of recording only the initial investment, CBO assumes that DoD would be allowed to finance much more housing construction than it records in obligations. Thus, CBO estimates that this additional construction activity would cost $149 million in 2005 and $2.2 billion over the 2005-2014 period.

Potential Effect on Future Discretionary Spending

Currently, funding for MHPI comes from the Family Housing Improvement Fund, which is financed by appropriations made to the fund, transfers from other accounts, receipts from property sales and rents, returns on any capital, and other income from operations or transactions connected with the program. DoD records its direct loans, loan guarantees, and cash contributions for those projects as obligations of funds in that account. Each year after that, DoD records obligations in military personnel appropriations for the Basic Allowance for Housing (BAH) paid to military families occupying the project housing. If the full amount of government spending were recorded up front in the budget, as CBO recommends, net outlays for BAH would be lower in the future, because a portion of those allowances would liquidate the spending already recorded in the budget. Such treatment would provide more accurate information to the Congress and the Administration, allowing an accurate comparison of the cost to provide military housing using traditional or alternative methods.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

H.R. 4879 contains no intergovernmental or private-sector mandates as defined in UMRA and would not affect the budgets of state, local, or tribal governments.

PREVIOUS CBO ESTIMATES

On May 16, 2003, CBO transmitted a cost estimate for H.R. 1588, the National Defense Authorization Act for Fiscal Year 2004, as reported by the House Committee on Armed Services on May 14, 2003. Section 2803 of that version of the legislation, would have increased the limit on DoD's investment using alternative authorities to acquire or improve military family housing from $850 million to $900 million. CBO estimated that enacting section 2803 would have increased direct spending for military family housing by $377 million over the 2004-2008 period and $409 million over the 2004-2013 period.

On May 17, 2004, CBO transmitted a cost estimate for H.R. 4200, the National Defense Authorization Act for Fiscal Year 2005, as reported by the House Committee on Armed Services on May 14, 2004. Section 2806 of that legislation would eliminate the investment cap on DoD's use of the alternative authorities to acquire or improve military housing, effective October 1, 2005. CBO estimated that enacting section 2806 would increase direct spending for military family housing by $365 million in 2006, $4.9 billion over the 2006-2009 period, and $6.6 billion over the 2006-2014 period.

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